

Troubled Debt Restructuring

Consider the following procedures at each examination. Examiners are encouraged to exclude items deemed unnecessary. This procedural analysis does not represent every possible action to be taken during an examination. The references are not intended to be all-inclusive and additional guidance may exist. Many of these procedures will address more than one of the Standards and Associated Risks. For the examination process to be successful, examiners must maintain open communication with bank management and discuss relevant concerns as they arise.

A Troubled Debt Restructuring (TDR) is defined as a restructuring in which a bank, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to the borrower that it would not otherwise consider.

1 Determine if the bank has restructured troubled debt. The restructuring may include the following:

1 A The transfer from the borrower to the bank of real estate, receivables from third parties, other assets, or an equity interest in full or partial satisfaction of the loan or other debt instrument.

1 B A modification of the loan terms.

1. Reduction in stated interest rate to below the current rate.
2. Extension of maturity at a favorable interest rate.
3. Reduction in the face amount of the debt.
4. Reduction in accrued interest.

1 C A combination of the above.

1 D A loan extended or renewed at a stated interest rate equal to the current market interest rate for new debt with similar risk is not to be reported as a restructured loan.

2 Determine if any troubled debts were restructured prior to 12-15-94. Loans restructured prior to 12-15-94 may continue to be accounted for and disclosed based on the undiscounted expected future cash payments.

3 Determine if any troubled debts were restructured after 12-15-94. Loans restructured after 12-15-94 are considered impaired per SFAS 114 and as amended by SFAS 118. A loan is considered impaired when the creditor determines, based upon current information, that it is probable the creditor will be unable to collect all principal and interest as scheduled, according to the original contractual terms of the loan agreement. (As a general rule impaired loans are categorized as nonaccrual loans per Call Report instructions.)

3 A Loan impairment is measured in the following three ways:

- 3 A1 1. Present value of expected future cash flow discounted at the loan's effective interest rate at inception as defined in SFAS 114 and amended by SFAS 118.
2. Loan's observable market price.
3. Fair value of collateral if the loan is collateral dependent.

3 B A loan is not impaired during a delay in payments if the creditor expects to collect all amounts due.

3 C Impairment does not apply to smaller balance homogeneous loans collectively evaluated for impairment (credit card loans, residential mortgage loans, consumer instalment loans). Those loans are accounted for at fair value or the lower of cost or market.

POLICY CONSIDERATIONS

4 Determine if policies and procedures include the following items:

4 A Guidelines on TDR accounting. (Basic criteria are set forth in SFAS 15, 114, 118, and Call Report Instructions.)

4 B Guidelines for approval of restructuring concessions and agreements.

ADMINISTRATION

5 Determine whether management has developed appropriate monitoring procedures for TDRs.

5 A Determine the process for approving restructured loans.

5 B Identify responsibility for monitoring TDRs.

5 C Evaluate the system(s) used to track TDRs.

6 Determine whether management has correctly identified TDRs in accordance with Call Report instructions.

6 A The 6-10-93 Interagency Policy Statement on Returning Certain Nonaccrual Loans to Accrual Status provides guidance for multiple note structures. (These loans qualify as TDRs, and generally the "A" notes of these structures can be returned to accrual status if they yield a market rate and demonstrate sustained repayment performance.)

7 Determine if impaired loans comply with SFAS 114 and SFAS 118.

8 Determine if the loan review function has identified any additional loans that should be categorized as TDRs.

9 Determine whether the loan review function encompasses TDRs. Ensure that the TDRs are considered in calculating the adequacy of the ALLL. (Examiners should be aware that regardless of the GAAP treatment for TDRs, the underlying collectibility is the final determinant in establishing the asset's value on the bank's books.)

DOCUMENTATION

10 Determine if appropriate documentation is retained to support TDR assumptions and conclusions.

CREDIT ANALYSIS

11 Review internal and external audit recommendations and assess the adequacy of remedial actions taken by management to correct TDR deficiencies.

12 Ascertain the volume of TDR in the bank's portfolio utilizing prior examination reports, recent Reports of Condition, and the off-site request list or first day letter.